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OFFICE OF REPORTS AND ESTIMATES, CIA
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WEEK OF 7 SEPTEMBER - 13 SEPTEMBER 1948

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SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

Building of ships in Japan for export held justified by the necessity to improve Japan's balance of payments (page 3).

Chinese Government representations concerning Siam have resulted in statement of US support for present Siamese regime (page 3).

In preparation for resumption of Diet proceedings, left-wing Socialists are attempting to secure Cabinet adoption of leftist legislative proposals as the price of continued support of the Ashida Government (page 4).

The men selected to head the new Democratic People's Republic of Korea are trusted Soviet puppets and can be counted on to advance Soviet interests at the UNGA meeting in Paris. At the same time the communist South Korea Labor Party is experiencing a tightening of Soviet control designed to increase its effectiveness (page 5).

Although the military situation in China remains relatively quiet, the Chinese Communists will probably launch a general offensive in all major sectors this autumn (page 6). Nationalist ability to successfully stave off a Chinese Communist attack in Manchuria will likely be impeded by the reported rift in the Manchurian command (page 6). The recently formed Communist North China Government is viewed as the probable forerunner to a larger Red Government over all the "Liberated Areas" (page 6).

A renewed effort by the Soviet-oriented Ho Chi Minh Government, to exploit growing French weaknesses in Indochina, appears to be developing (page 9).

NOTE: In succeeding sections of this Weekly, the following marginal notations are used:

- (1) Double asterisk (**) --placed at beginning and end of information based solely on "S/S distribution" series.
- (2) Single asterisk (*) --to flag item containing "S/S distribution" series.
- (3) "A", "B", or "C" --importance, in B/FE's opinion, of the item, with "A" representing the most important ones.

~~SECRET~~~~CONFIDENTIAL~~

~~SECRET~~

-2-

SUMMARY (continued)

The UK press, which is almost the only source of information regarding conditions in Malaya continues to show concern over the situation (page 9).

The Philippine Government is resuming military action against the Huks (page 9).

The economic consequences of the insurrection in Burma are becoming serious (page 10).

The growth of Communist influence in Indonesia has been accelerated by the stalemate in GOC negotiations (page 11).

~~SECRET~~

SECRET

-3-

SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

Japan's building of ships for export held justified

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The Department of State has advised the UK that the principal consideration causing SCAP to authorize the construction in Japan of ships for foreign account is the necessity to improve Japan's balance of payments position. The income derived from the sale of these ships can be used to purchase raw materials for the production of other export items, which thereby contributes to industrial recovery, reduction of occupation costs and the eventual attainment by Japan of a self-support status. Thus, the Department states, it will be possible to realize one of the principal objectives of the occupation -- the economic recovery of Japan to a self-supporting status.

The reply of the Department of State to the UK will probably not allay the UK's fears over Japan's resumption of shipbuilding on a large scale (see B/FE Weekly 6 July - 13 July 1948 and ORE Weekly 3 September 1948). As the Japanese shipyards increase the tempo of their activity, the objections of the UK may be expected to increase. However, the force of their opposition is diminished by the fact that other maritime powers such as France, Norway, Denmark, and Sweden desire Japanese-built ships for their own economic purposes.

The Chinese National Government regards Siam with increasing disfavor

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Following the submission by the Chinese Government of a formal note of protest to the Siamese Embassy in Nanking concerning discrimination against Chinese in Siam, China's Vice Minister of Foreign Affairs has continued diplomatic representations concerning this problem. The Vice Minister has indicated to US representatives in Nanking that China cannot approve of the current Siamese regime although that government shares with the Chinese Government similar views on Communism. The Vice Minister implied that China would welcome an opportunity for more positive action to bring about the overthrow of the Phibul regime.

In reply to these Chinese overtures, the US Department of State has instructed the US Embassy in Nanking to inform the Chinese Government that since the Siamese Government is anti-Communist and friendly to the US, it does not object to the regime of Premier Phibul and desires the rehabilitation of Siam on a sound economic basis. Furthermore, the US desires to support rather than weaken a friendly government which exhibits the possibility of achieving political stability.

Unless the preoccupied Chinese Government has made commitments of support to anti-Phibul elements which it is capable of carrying out, it is doubtful that stronger and more direct protests will be made by the Chinese Government.

SECRET

SECRET

-4-

JAPAN

Left-wing Socialists bargain for legislative program. Key political maneuvers "B" evident in anticipation of the resumption of Diet proceedings are left-wing Socialist attempts to secure Cabinet adoption of leftist legislative proposals as the price of continued support of the Ashida Government. Embittered by conservative domination of the coalition cabinet, exasperated by Diet failure to pass the Socialist-sponsored war-bond interest payment suspension bill, and embarrassed by the government's excessively harsh interpretation of General MacArthur's "suggestions" regarding the trade union rights of government employees, left-wing Socialists have clamored for Socialist withdrawal from the government. Even Party Chairman, former Premier, KATAYAMA Tetsu, a middle of the roader, has publicly advocated Diet dissolution despite right-wing Socialist disavowals of the necessity thereof. Left-wing "realists" believe that by remaining in the government they may forestall the establishment of a more conservative government likely to result from cabinet reorganization or Diet dissolution at this time. These leftists are leading attempts in Socialist Party executive sessions currently in process to strengthen the Socialist--and their own--bargaining position in unifying the Party stand on essential legislative issues.

Foremost among the issues which the left-wing Socialists are raising is the demand for passage of the interest payment suspension measure, the enactment of which was promised in the original agreement for Socialist participation in the government. In addition, left-wingers are seeking adoption of measures designed to increase popular support for the party, particularly in labor. The principle items in this category are: (a) boosts in the basic wage rate to be calculated on the basis of living costs rather than on revenues; (b) extension of the farmland reform program; and (c) modification of the proposed revision of National Public Service Law to permit collective bargaining by all government employees and the right to strike by industrial workers in government employment.

The extent to which these attempts to secure adoption of some portion of the Socialist Party programs depend: (1) on the relative incompatibility of conservative elements within and outside the government, which incompatibility has to date prevented a conservative merger; and (2) in the final analysis, on the attitude of GHQ, SCAP whose interests in Japan's economic recovery has been interpreted by the Japanese to necessitate: (a) balancing of the budget; (b) elimination of the disruptive capabilities of labor; and (c) avoidance of measures which might deter the importation of private capital into Japan.

SECRET

SECRET

-5-

KOREA

Trusted party-line Communists control the Soviet satellite government newly- "B" established in North Korea. The same men who held key positions in the North Korean People's Committee continue in power in the Democratic People's Republic, although a number of South Koreans have been given positions of titular importance. Within seven days the Supreme Korean People's Assembly has: (1) ratified a constitution; (2) selected a premier and been informed of the formation of the government; (3) resolved to request the withdrawal of Soviet and American forces; and (4) empowered the government to send representatives to the UNGA meeting in Paris. These representatives will undoubtedly be used by the Soviet delegation to confuse UNGA action by denouncing the Rhee regime in South Korea as a US puppet and by advancing competitive claims for recognition as a truly national and democratic Korean Government.

The Communist South Korea Labor Party (SKLP) has been effecting a reorganization similar in nature to the tightening of control and discipline in communist parties elsewhere. The elimination of deviationists, stronger central control of party activities, and the establishment of a separate Intelligence Bureau as part of the Asiatic Cominform network are some of the features of this reorganization. The SKLP is in a very weak position at the present time following two years of continuing failure to attain its objectives and steady diminution of popular support. Most of the able party leaders have gone north to take positions in the People's Republic. The remaining party members are being constantly harrassed by both the South Korean police and rightist youth organizations. The incessant invasion threats emanating from North Korea are designed, in part, to sustain the sagging morale of the faithful in South Korea with the thought that their day of power will soon be realized.

SECRET

SECRET

-6-

CHINA

A Communist general offensive, probably this autumn, is anticipated "A" somewhat apprehensively by the National Government. The long lull, extending over the past five months in Manchuria, has given the Communists an opportunity to re-equip, regroup and train new forces. Communist strength in Manchuria, accordingly, now totals about 18 columns, giving them an overwhelming numerical advantage over the Nationalist defenders. The Nationalist-held city of Changchun, isolated for more than 15 months, will probably fall in the near future; its fall will release Communist troops for action against Mukden or the Chinhhsien corridor, both primary targets. However, it appears likely the Communists will not try to take Mukden by assault, but will content themselves with reducing its present perimeter while bringing their main body to bear on the coastal corridor leading south from Chinhhsien into China Proper. Concurrently, Communist forces in North China will keep FU Tso-yi occupied to the south and west of Peiping, forcing him to leave his northern flank inadequately protected. Communist forces in the Central China area at present may be aiming at the isolated Nationalist pockets of resistance (e.g., Tsinan or Taiyuan) before moving into the Yangtze Valley in force. Actually, the timing as well as the locus of any actions remain at the discretion of the Communists. (A map showing the military situation in China as of 1 September 1948 will be available for ORE Weekly of 17 September.)

A split appears to have developed in the Manchurian headquarters of WEI Li-huang. Reports indicate that a number of WEI's top-ranking subordinate officers are of the opinion that, at present, the wisest strategic course for the Nationalists would be to launch an offensive south of Mukden (where the Communists are comparatively weak), thus opening a rail corridor to the seaport of Yingkou. WEI, however, remains adamant in his desire to sit tight and preserve his troops and his unbroken string of "victories" over the Communists. This rift, coupled with WEI's mounting supply and food problems—the critical nature of which, say these generals, WEI fails to grasp—further vitiates the Nationalists' power of resisting expected Communist attacks. **"B"

The creation of the Communist North China People's Government is viewed as a forerunner of a larger Communist government later to be established for all "liberated" areas. The Communists with help of the Kuomintang dissidents are already planning to convene a People's Consultative Conference for the formation of such an over-all Communist government. The recently formed North China government apparently will have jurisdiction over the North China Liberated Area. The latter was created by the merger of two of the border regions announced last May.

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SECRET

SECRET

-7-

The Chinese Communists are making important advances in consolidating their regime. By their military victories they have united scattered areas that formerly were largely autonomous and now are ready for more unified control. Plans for a People's Consultative Conference seem to be progressing with the Communists reportedly arranging for several Hong Kong dissident leaders to go to North China for a preliminary meeting. The actual conference however, will probably not take place for a few months. If an expanded Communist government results from this conference it will be a key factor in future Sino-Soviet relations, i.e., the Soviet attitude toward such a government will have a profound effect on the position of the USSR in China.

The reported accidental death of "Christian General" FENG Yu-hsiang in "B" the Black Sea on the Soviet steamer "Pobeda" may lead to a Chinese Government request to the USSR to explain why it granted FENG a transit pass to proceed to Chinese Communist areas with the avowed intention of joining the Chinese "Reds" against the National Government, thus violating the Sino-Soviet Treaty of 1945. In the meantime the Nanking Foreign Office has raised with the Soviet Embassy the question of whether or not the reported death of FENG may be fraud, and wishes US confirmation that FENG actually left the US on a Soviet vessel. Chinese Communist leaders, MAO Tze-tung and CHU Teh, apparently giving the report full credence, have telegraphed their condolences to Mr. FENG and to the dissident Kuomintang Revolutionary Committee in Hong Kong.

The Tibetan Trade Mission has asked the US for a temporary loan of "C" \$2,000,000 for the purchase of 50,000 ounces of gold to be used to stabilize Tibet's currency, explaining Tibet has sufficient rupee exchange in banks in India to serve as collateral for the loan. The mission says the loan will strengthen Tibet's bargaining position looking toward a revision of the Treaty between Tibet and British India (which conferred special privileges and border territory to the UK). The Mission expects to leave New York for the UK in about 10 days. The Chinese Embassy in Washington again has reiterated the Chinese Government's claim of suzerainty in Tibet.

Evidence of certain Chinese industrialists' interest in ECA reconstruction in Western Germany is indicated by an inquiry from Nanking businessmen anxious to learn established procedures for ascertaining the availability of generating equipment, transformers, spares, etc., for export to China. There are in China a large number of installations of German manufactured machinery, so German manufacturers would be the logical supply source for repair or expansion of these installations. "C"

Government Controls Dominate the New Currency Program. Although "C"

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wholesale prices have remained relatively stable at a high level since the new currency was inaugurated 19 Aug., the price structure is far from built on a normal, sound basis. The price scale in Chungking and Tientsin generally has been maintained in face of the loose money market and police surveillance. In Hankow the situation is apparently out of hand with prices rising rapidly. Canton prices have increased about 85% over 19 Aug.; Mukden prices also are generally up. Shanghai retail prices have shown a tendency to rise despite controls holding down wholesale prices. Intensified activities of the economic police are a major force in effecting stability and apparent public confidence in the new currency. Meanwhile, the volume of commercial transactions in Shanghai is reported to have diminished greatly due to price freezing and strict Government controls, resulting in the strangulation of normal business functions. The Government is thus faced with the necessity of making a choice between: a.) tight controls and business stagnation on one hand, or b.) loose regulations and possible breakdown of the new currency on the other.

There is yet no confirmation of a real black market for foreign exchange coming into existence; however, there are reports of individual transactions and forward sales in US dollars at rates ranging from GY \$4.10 to GY \$5.65 for US \$1, the highest being reported in Mukden.

Gold Yuan Note Circulation. An unconfirmed report places China's total gold yuan note issue up to 31 Aug., 12 days after the official introduction, at GY #290 million (US \$72.5 million). When compared on a US dollar basis the new currency issue now exceeds by 20% the total CN dollars in circulation at the time it was replaced. (Total CN dollar circulation reached an estimated peak, 19 Aug., of CN \$700 trillion, equivalent to US \$58.3 million.) Finance Minister WANG Yun-wu announced that as of 9 Sept. a total of US \$44 million in foreign currencies, gold and silver, had been turned in for exchange.

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SECRET

SECRET

-9-

INDOCHINA

Stronger effort against French "colonialists" promised by Ho Chi Minh. A renewed effort by the Soviet-oriented Ho Chi Minh Government, to exploit growing French weaknesses in Indochina, appears to be developing. At a special meeting called on 2 September to commemorate the third anniversary of the founding of his Republic, Ho reviewed the general situation. Politically, he pointed out growth in prestige of his government as well as a stronger international position. He maintained that the army and militia have "come of age" morally and materially and are backed up by increased production of arms and ammunition. He reaffirmed the position of his government to be that of "friendly cooperation with the French people on the basis of independence and equality, but not false independence and unity which will bring back enslavement." Ho stressed the distinction between the French "people" and the "colonialists" whom he alleges have attempted negotiations with "puppets who do not represent the Vietnamese people" and demanded definitive action against them. It is apparent that the Ho Chi Minh regime is determined in its objectives, since a recent official communique is reported to have declared the existence of a state of war in Vietnam. Increased sabotage and guerrilla activity in north and south Vietnam (Tonkin and Cochinchina) are being reported. In addition, regulations suggesting action against "foreign" aircraft and shipping have been announced.

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MALAYA

UK press continues to indicate concern over Maleyan situation. UK concern over the situation in Malaya can be judged, somewhat by the extensive coverage in the British press which unfortunately is almost the only source of information regarding conditions in Malaya. Although the UK concern may be somewhat out of proportion to actual losses of life and property, it is apparent that the British are still confronted with a serious problem. Through the middle of August, 11 European civilians and 106 Chinese and Malays are reported to have been murdered. Small amounts of stored rubber are reported to have been damaged or destroyed, eight plantation manufacturing plants seriously damaged and several plans for replanting or new planting of rubber trees postponed or canceled. Widespread incidents of violence continue despite vigorous precautionary and military measures undertaken by British authorities. Although the overall production of tin and rubber has not yet dropped, it will continue to be threatened until law and order is restored.

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PHILIPPINES

Government resumes military action against Huks. Declaring that the Huks are now in a state of rebellion, President Quirino informed the US Charge' in Manila on 13 September that the Constabulary, the Army, and

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SECRET

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-10-

PHILIPPINES (continued)

"guerrilla units" have now embarked on an anti-Huk military campaign. The President said that the Armed Forces have completely surrounded the central Luzon area in which Huk leader Taruc and his main group are supposed to be located. The Embassy reports that Quirino, who now seems as determined to conquer the Huks by force as he was formerly to subdue them peacefully, wishes personally to supervise the anti-Huk military action which he desires to complete "before the outbreak of war in Germany." The President emphasized in the interview that Taruc has lost all amnesty benefits and that, should the Huk chief answer a summons to appear in Manila before the congressional electoral board, he would be apprehended immediately on a murder charge. Despite his apparent policy reversal, the President also emphasized his determination to continue the Government's peasant amelioration program under protection of the Armed Forces and stated that anyone interfering with the program would be considered an enemy of the nation.

While the Armed Forces may be able to control large-scale Huk activities, bloody clashes are expected to continue in central Luzon where the death toll has mounted to an estimated 155 persons since amnesty expired on 15 August. Moreover, Quirino's social amelioration program is at best a palliative as thorough study and planning will be required to resolve the fundamental problem of traditional inequities in the agrarian economy. In addition to the problem of effectively employing "guerrilla units" to cope with Huk "hit-and-run" tactics, the Constabulary will be faced with problems of maintaining adequate supplies and equipment and of exercising more strict control of firearms imports and distribution to prevent diversion into unauthorized channels. General Castaneda, Chief of Constabulary, has already discussed the possibility of US logistical support with the local US Army commander. More determined attempts may be made to secure US aid under the US-Philippine Military Assistance Agreement as the Government's punitive campaign against the Huks progresses.

BURMA

Economic consequences of insurrection becoming serious. The hydra-headed insurrection in Burma, which began with the uprising of the Burma Communist Party in March 1948, is having serious economic consequences. The two most serious economic effects of the insurrection are the greatly increased military expenditures and the heavy losses of revenue from the curtailment in the exports of rice. In addition, irrigation canals and government buildings have been destroyed, and government treasuries and rice stocks have been looted. Furthermore, the Government is sustaining substantial losses of revenue from the failure to collect land rents in large areas and from the operations of public utilities. On top of all these difficulties, Burma's currency has been sadly mismanaged by incompetent personnel in the

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SECRET

-11-

BURMA (continued)

Finance Ministry. As a result, Burma's 1947-48 budget, which was expected to have been balanced, will now show a deficit of at least \$18,500,000. Moreover, one of Burma's leading newspapers, owned by the Finance Minister, predicts that the 1948-49 budget will have a deficit of at least \$100,000,000 which is probably more correct than the \$33,000,000 deficit as estimated in the official budget. Inflationary tendencies have been visible in the last few weeks, and it is questionable if the rupee can be maintained at its present rate of exchange if the insurrection, loss of revenue and mismanagement continue. Although the Government has taken steps to forestall economic collapse by doubling the export duty on rice, increasing tariffs, enhancing entertainment and excise taxes, and levying a new 16½% tax on all business profits amounting to more than \$35,000, such measures are merely expedients. Unless political stability is restored or considerable foreign financial assistance is obtained in the near future, economic deterioration will become increasingly serious.

INDONESIA

Growth of Communist influence accelerated by stalemate in negotiations. "A" Political alignments in the Republic of Indonesia are rapidly splitting into Communist or anti-Communist camps. Until recent months the left-wing opposition posed no serious problems to Premier Hatta's moderate government although Republican armed forces were frequently used to subdue extremist elements. The left-wing became an actual threat to the Government, however, after the 22 May announcement by the Soviets indicating willingness to exchange consular representatives with the Republic. This action gave pro-Soviet political parties strength and encouragement. By August a Soviet-trained Indonesian Communist had made considerable headway in reorganizing loose left-wing parties into a stronger, militant Indonesian Communist Party (PKI). On 1 September former Premier Sjarioeddin, chairman of the more left of the Republic's two Socialist parties, declared that his party had been incorporated into the Communist Party thus insuring the pro-Soviet groups of some popular leadership. The Labor Party and SOBSI (Republican Federation of Labor Unions) are also reported to have been amalgamated with the Communist Party.

Premier Hatta has resolved to take strong measures against "destructive elements" who promote anarchy or threaten public security. In this resolution he is backed by the moderate PNI (Nationalist Party) and right-wing Masjumi (Moslem) party, which have both refused a Communist Party invitation to form a national front. Tensions building up within the Republic continue to accelerate and it is probable that Hatta's fight against Communism will involve a major military operation.

SECRET

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~~CONFIDENTIAL~~

-12-

INDONESIA (continued)

The ultimate outcome of the struggle of non-Communists versus Communists in Indonesia depends almost wholly upon a satisfactory settlement of the Dutch - Republican dispute. As long as the negotiations, now being conducted under the auspices of the UN Good Offices Committee, remain stalemated, Communist elements will continue to gain strength by fomenting discontent within the Republic and promoting incidents which contribute to the general feeling of uneasiness.

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